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No. 00-1567

In the Supreme Court of the United States

Cornelius P. Young and Suzanne P. Young,
Petitioners,

v.

United States of America,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITIONERS' BRIEF ON THE MERITS

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QUESTIONS PRESENTED

1. Whether the Youngs' 1992 income tax obligation was discharged by the entry of a discharge in their 1997 chapter 7 bankruptcy case where the three-year period set forth at §507(a)(8)(A)(i) of the Bankruptcy Code had elapsed between the due date of their tax return and the filing of their chapter 7 bankruptcy case.

2. Whether the three-year period set forth at Bankruptcy Code §507(a)(8)(A)(i) was tolled or extended by the length of time that the Youngs were debtors in a prior chapter 13 bankruptcy proceeding, notwithstanding the absence of any language in §507(a)(8)(A)(i) or elsewhere that allows such tolling.

PARTIES TO THE PROCEEDING

Petitioners

Cornelius Paul Young and Suzanne P. Young, individuals with no corporate affiliations.

Respondents

The United States of America

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The opinion of the court of appeals is reported at *Young v. United States (In re Young)*, 233 F.3d 56 (1st Cir. 2000). The Order of the United States District Court for the District of New Hampshire is not reported, but is reproduced in App. C of the Petition for Certiorari at 12a-13a (hereinafter App. to Pet. for Cert.). The opinion of the United States Bankruptcy Court for the District of New Hampshire is reported at *Young v. United States (In re Young)*, 1999 Bankr. Lexis 557; 99-1 U.S. Tax Cas. (CCH) ¶50,553; 83 A.F.T.R.2d (RIA) 2876.

JURISDICTION IN THIS COURT

The opinion of the United States Court of Appeals for the First Circuit was issued on December 1, 2000, and was modified by an *Errata* issued December 20, 2000. A petition for a writ of certiorari was filed with this Court on March 1, 2001, within 90 days of the December 1, 2001, opinion, as required by Supreme Court Rule 13. This court has jurisdiction under 28 U.S.C. §1254(1).

STATUTES INVOLVED

The statutes involved are found either in the Bankruptcy Code, 11 U.S.C. 101 *et seq.*, hereinafter sometimes cited as Bankruptcy Code §__, or in the Internal Revenue Code, 26 U.S.C. 101 *et seq.*, hereinafter sometimes cited as IRC §_. The particular provisions of the Bankruptcy Code and the Internal Revenue Code are as follows:

Bankruptcy Code §727

(a) The court shall grant the debtor a discharge,....

(b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter,'....

Bankruptcy Code §523

(a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt —

(1) for a tax or a customs duty —

(A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, if required —

(i) was not filed; or

(ii) was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax; . . . .

* * * *

(b) Notwithstanding subsection (a) of this section, a debt that was excepted from discharge under subsection (a)(1), (a)(3), or (a)(8) of this section . . . in a prior case concerning the debtor under this title, or under the Bankruptcy Act, is dischargeable in a case under this title unless, by the terms of subsection (a) of this section, such debt is not dischargeable in the case under this title.

Bankruptcy Code §507(a)

(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for —

(A) a tax on or measured by income or gross receipts —

(i) for a taxable year ending on or before the date of filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition; [or]

(ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition;. . . .

Bankruptcy Code §108(c)

Except as provided in section 524 of this title, if applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor . . . and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of—

> (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
>
> (2) 30 days after notice of the termination or expiration of the stay under section 362, 922, 1201, or 1301 of this title, as the case may be, with respect to such claim.

Bankruptcy Code §105(a)

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

Internal Revenue Code §6501

(a) General rule.

Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in a court without assessment for the collection of such tax shall be begun after the expiration of such period.

Internal Revenue Code §6502

Collection after assessment:

(a) Length of period.

Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or a by proceeding in court, but only if the levy is made or the proceeding begun—

> (1) within 10 years after the assessment of the tax, or
>
> (2) prior to the expiration of any period for collection agreed upon in writing by the Secretary and the taxpayer before the expiration of such 10-year period . . .

Internal Revenue Code §6503

* * * *

(b) Assets of taxpayer in control or custody of court.

The period of limitations on collection after assessment prescribed in section 6502 shall be suspended for the period the assets of the taxpayer are in the control or custody of the court in any proceeding before any court of the United States or any State or of the District of Columbia, and for 6 months thereafter.

* * * *

(h) Cases under title 11 of the United States Code.

The running of the period of imitations provided in section 6501 or 6502 on the making of assessments or collection shall, in a case under title 11 of the United States Code, be suspended for the period during which the Secretary is prohibited by reason of such case from making the assessment or from collecting and—

(1) for assessment, 60 days thereafter, and
(2) for collection, 6 months thereafter.

STATEMENT OF THE CASE

The petitioners, Mr. and Mrs. Young, filed their 1992 federal income tax return with the Internal Revenue Service (the "IRS") on October 15, 1993, after obtaining extensions from the usual April 15 filing date. App. 5-6. The IRS assessed the tax in accordance with IRC §6501 on January 3,

1994. App. 6. Since the Youngs had not paid their tax obligation, they made monthly installment payments to the IRS between April 1994 and November 1995, initially at $50 per month and later $300 per month. App. 7-8. The Youngs did not sign or file an offer in compromise with respect to this tax obligation. App. to Pet. for Cert. 15a; App. 5-8.

The Youngs then filed a chapter 13 bankruptcy proceeding in the United States Bankruptcy Court for the District of New Hampshire on May 1, 1996. App. 9-10. By doing so, the automatic stay under Bankruptcy Code §362(a) immediately came into effect, thereby preventing creditors — including the IRS — from collecting debts, including tax obligations, from the Youngs. During the chapter 13 proceeding, the Youngs filed a chapter 13 plan which provided, among other things, for the sale of their residence in Bedford, New Hampshire, and in connection with this sale, the payment of closing costs, tax liens and mortgages on the property. App. 12-13, 28-30. It also provided for payment in full of their 1992 priority income tax obligation, as specified in the IRS' amended proof of claim (App. 23), over a five-year period through monthly plan payments of $300 each made through the chapter 13 trustee. App. 30-31. The bankruptcy court below specifically stated that it ". . . imputes no bad faith on the Plaintiffs . . ." in connection with their bankruptcy proceedings. App. to Pet. for Cert. 20a.

After their house was sold, the debtors' employment of special counsel, Attorney Norene Farr, was dealt with by the bankruptcy court. App. 14-15. The Youngs then elected to file a notice of voluntary dismissal of their chapter 13 case in accordance with §1307 of the Bankruptcy Code, and did so on October 23, 1996. App. 15, 32. Between the date of the filing of their chapter 13 petition on May 1, 1996, and the filing of their notice of dismissal on October 23, there elapsed

176 days, or almost six months. Since their chapter 13 plan had never been confirmed, the plan payments they had made to the trustee were returned to the Youngs in accordance with Code §349(b)(3). Thereafter, after an administrative expense request of the chapter 13 trustee was granted, the Youngs' chapter 13 case was closed on March 13, 1997. App. 16-17.

On March 12, 1997, the Youngs filed a chapter 7 bankruptcy petition in the New Hampshire bankruptcy court. App. 35. They were granted a chapter 7 discharge on June 17, 1997, after which, on September 22, 1997, their chapter 7 case was closed. App. 36. It was then reopened on July 13, 1998, at the Youngs' request, to allow them to file a complaint with the bankruptcy court to determine whether their 1992 income tax obligation had been discharged. App. 37.

SUMMARY OF ARGUMENT

The Bankruptcy Code permits the discharge of a taxpayer's income tax obligation for a taxable year for which the tax return is due more than three years before the filing of the debtor's bankruptcy petition. Since the Youngs filed their chapter 7 bankruptcy petition on March 12, 1997, approximately three years and five months after the filing of their 1992 income tax return on October 15, 1993, their 1992 income tax obligation was discharged by reason of the discharge they received in their chapter 7 case. Sections 727(b), 523(a)(1)(A) and 507(a)(8)(A)(i) of the Bankruptcy Code command this result. Because these provisions are unambiguous, their plain language controls and no resort to notions of equitable tolling or to legislative intent is required or even permitted. This result is also mandated by the explicit provision of §523(b) which provides that tax and other claims not dischargeable in an earlier bankruptcy can nevertheless be

discharged in a later one.

This result is also supported by legislative history, which demonstrates that Congress carefully struck a balance between the need for the debtor's fresh start, the need of general creditors to recover from a debtor's bankruptcy estate and protection of the public treasury from wholesale tax avoidance. Congress has developed an intricate statutory scheme in both the Bankruptcy Code and the Internal Revenue Code that specifies under what circumstances the time periods for the assessment and collection of income taxes can be tolled or enlarged, and the absence of such a provision in Bankruptcy Code §507(a)(8)(A)(i) is not simply an oversight on the part of Congress.

Nevertheless, a majority of courts that have considered this matter have judicially grafted into §507(a)(8)(A)(i) an extension or tolling period. The policies that are said to support this grafting are the supposed inability of the tax collector to collect taxes in the face of the automatic bankruptcy stay, the supposition that the three-year period in §507(a)(8)(A)(i) is a period for collection of tax rather than a definition of which taxes are dischargeable, and the potential for abuse and manipulation by taxpayers who file for bankruptcy. These assumptions do not hold water. In reorganization cases, debtors are required to pay their nondischargeable tax obligations in full. The period for collecting taxes is set forth in the Internal Revenue Code, and not in Bankruptcy Code §507(a)(8)(A)(i). Furthermore, the possibility of manipulation and abuse is constrained by multiple provisions of the Bankruptcy Code. Finally, §105(a) of the Bankruptcy Code does not permit bankruptcy courts to gerrymander a tolling or extension provision onto §507(a)(8)(A)(i). Section 105(a) can only be used in a manner consistent with the commands of the Bankruptcy Code and

cannot alter substantive rights.

ARGUMENT

I. UNDER THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE, THE YOUNGS' 1992 INCOME TAX OBLIGATION HAS BEEN DISCHARGED.

As indicated in the Statement of the Case, the Youngs filed their form 1040 federal income tax return for the 1992 calendar year on October 15, 1993, and the IRS assessed the taxes on January 3, 1994. About three years and five months after filing this tax return, the Youngs filed a chapter 7 bankruptcy petition on March 12, 1997. They were granted a chapter 7 discharge pursuant to §727 of the Bankruptcy Code on June 17, 1997.

In accordance with §727(b), this discharge discharged the Youngs from all debts arising before the order for relief "[e]xcept as provided in section 523 of this title . . . ." § 523(a), in turn, provides that a discharge issued under §727 does not discharge individual debtors from any debt

> (1) for a tax or a customs duty —
>
> (A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(8) of this title, whether or not a
>
> claim for such tax was filed or allowed;

Turning to §507(a)(8), (§507(a)(2) does not apply in the Youngs' situation) we find the following language:

> (8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for —
>
> (A) a tax on or measured by income or gross receipts —
>
> (i) for a taxable year ending on or before the date of filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition; [or]
>
> (ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition;...

Simply put, the Youngs' chapter 7 discharge discharges their 1992 income tax obligation because they filed their chapter 7 petition more than three years after the extended due date for filing their tax return. This is the result commanded by the plain meaning of these statutory provisions. These provisions, although somewhat convoluted, are not ambiguous, and consequently the plain meaning of the language controls. As this Court said in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), "The plain meaning of legislation should be conclusive, except in the rare cases in which the literal application will produce a result

demonstrably at odds with the intentions of its drafters." *Id.* at 242 (Internal quotes, brackets and citations omitted).

The plain meaning of the legislation requires, contrary to the holdings of the courts below, that the Youngs' 1992 income tax obligation be discharged by their 1997 chapter 7 bankruptcy proceeding. If any doubt remains as to the dischargeability of the Youngs' 1992 tax obligation, it is dispelled by §523(b), which addresses dischargeability of certain debts when debtors file serial bankruptcies:

> Notwithstanding subsection (a) of this section, a debt that was excepted from discharge under subsection (a)(1), (a)(3), or (a)(8) of this section, . . . in a prior case concerning the debtor under this title, or under the Bankruptcy Act, is dischargeable in a case under this title unless, by the terms of subsection (a) of this section, such debt is not dischargeable in the case under this title.

The Youngs' sequential filings are fully with the ambit of Code §523(b). Their chapter 13 petition was filed on May 1, 1996, *less* than three years from the filing of their 1992 income tax return on October 15, 1993. By reason of Code §1322(a)(2), their chapter 13 plan had to (and did) provide for the ". . .full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title. . . ." Code §507 in turn defines which claims are entitled to priority of distribution and the order of priority, and it includes as the eighth priority at §507(a)(8)(A)(i) income taxes for which returns were due within the three-year period preceding the bankruptcy filing — in other words, the Youngs' 1992 income tax obligation.

Yet when the Youngs filed their chapter 7 petition on March 12, 1997, *more* than three years had elapsed since they filed their 1992 tax return on October 15, 1993. In this proceeding, the taxes were dischargeable by the application of §§ 727(a), 523(a)(1)(A) and 507(a)(8)(A)(i). Section 523(b) precisely contemplates this result, and although it deals specifically with successive bankruptcy filings by a debtor, it contains no language about tolling or extending time periods where the lapse of time enters into the definition of what debts are dischargeable. Section 523(b) refers to debts excepted from discharge under (a)(1) (recent tax obligations), (a)(3) (debts not listed in time for a creditor to file a proof of claim or bring a non-dischargeability action), and (a)(8) (educational or student loans that have been in repayment for more than seven years[1]). For these time-related debts, Code §523(b) specifically permits discharge in a subsequent bankruptcy proceeding although not discharged in an earlier one — which is precisely the Youngs' situation.

II. THE RESULT REACHED FROM A PLAIN READING OF THE STATUTES IS CONSISTENT WITH LEGISLATIVE INTENT.

The result at which we arrive from a plain reading of the statutes is consistent with, not contrary to, the intent of Congress, as expressed in legislative history, other sections of the Bankruptcy Code and sections of the Internal Revenue Code that deal with the assessment and collection of income taxes.

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[1] This seven-year provision was repealed on October 7, 1998, leaving "undue hardship" as the only grounds available to discharge student loans.

A. A primary purpose of bankruptcy is to provide debtors with a fresh start.

One main objective of Congress in enacting bankruptcy legislation in general, and the Bankruptcy Code in particular, is to provide individual debtors a "fresh start" unencumbered by the burden of unmanageable debt. As this Court stated long ago, "A primary purpose of the bankruptcy act is to relieve the honest debtor of the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." *Westmore v. Markoe*, 196 U.S. 68, 77 (1904). As the provisions of Bankruptcy Code §523 make clear, however, the debtor's "fresh start" is not always entirely free of prior obligations, since Congress has provided, for reasons of public policy, that certain debts remain undischarged. The most common among these that affect individual debtors are obligations for alimony and child support (§523(a)(5)), student loan obligations (§523(a)(8)) and, of course, recently incurred tax obligations, whether federal, state or local (§§523(a)(1) and 507(a)(8)).

B. Congress also intended to relieve bankruptcy debtors of their obligation to pay stale tax claims.

The intention of the drafters of the three-year measure for determining which income taxes are discharged was, as the court of appeals below correctly stated, to "prevent large accumulations of tax claims" that "remain unpaid for long periods of time." (App. to Pet. for Cert. 4a-5a). To remedy this, Congress enacted, in 1966, section 35(a) of the Bankruptcy Act, which provided that, "A discharge in bankruptcy shall release a bankrupt from all of his provable debts . . . except . . . taxes which became legally due and

owing by the bankrupt within three years preceding bankruptcy . . . "

The legislative history also expresses a concern for general creditors. The court in *United States v. Norton,* 717 F.2d 767 (3rd Cir. 1983) summarized the legislative history in the following manner:

> The legislative history of the Bankruptcy Reform Act is replete with references to the effect the proposed legislation would have on the collection of taxes. *See, e.g.*, S Rep. No. 1106, 95th Cong., 2d Sess. (1978) (Committee on Finance); S. Rep. No. 989, 95th Cong. 2d Sess. (Judiciary Committee) *reprinted* in 1978 U.S. Code Cong. & Ad. News 5787. These references make clear that the Bankruptcy Code attempts to reconcile three sets of interests that usually co-exist in tension: the interests of general creditors who do not want a debtor's funds to be exhausted by accumulated back taxes; the interests of debtors whose "fresh start" should not be burdened by accumulated taxes; and the interests of the public in not losing taxes whose collection the law has restrained.

In balancing these interests, the Congress gave the IRS a priority claim on the assets of a debtor's estate for tax liabilities that had not grown so "stale" as to burden general unsecured creditors who may have extended credit after the liabilities arose. To avoid hampering the debtor's fresh start, Congress coordinated the priority and discharge

provisions of the Code so that unpaid taxes accorded priority are nondischargeable, while tax claims that are not given priority are usually not collectible from the debtor's post-bankruptcy assets. S. Rep. No. 1106, *supra* at 5; S. Rep. No. 989, *supra* at 14-15.

Id. 770.

Notably absent from this legislative history is any mention that the three-year measuring period was intended to serve as a period for *collection* of a tax obligation.

III. OTHER PROVISIONS OF THE BANKRUPTCY CODE AND INTERNAL REVENUE CODE MAKE EXPLICIT PROVISION FOR EXTENDING IRS TAX ASSESSMENT AND COLLECTION DEADLINES WHILE §507(a)(8)(A)(i) DOES NOT.

Other provisions of the Bankruptcy Code demonstrate that Congress did not intend the three-year measuring period in §507(a)(8)(A)(i) to be tolled or extended for any reason other than the one expressly set forth in the statute — the duration of any filing extension granted by the IRS from the normal April 15 filing deadline.

Congress enacted an explicit extension provision in the very next subparagraph that follows §507(a)(8)(A)(i). Section 507(a)(8)(A)(ii) provides that an income tax obligation is not discharged if it was assessed less than 240 days prior to the filing of a debtor's bankruptcy petition. It also provides, however, that if the debtor had filed an offer in compromise with respect to his tax obligation during the 240-day period, the period is enlarged by the length of time that the offer in compromise is pending, plus an additional 30 days.

When a taxpayer files an offer in compromise, the IRS normally suspends collection activities with respect to the tax obligations that are the subject of the offer.[2] The explicit enlargement or tolling provision in Bankruptcy Code §507(a)(8)(A)(ii) permits the IRS to consider the taxpayer's offer in compromise without fear that its time to collect the tax will expire should the offer be rejected.

The presence of an explicit extension or tolling provision in §507(a)(8)(A)(ii) contrasts sharply with the absence of one in the subparagraph immediately preceding it. We submit that the omission of an extension provision in §507(a)(8)(A)(i) is not an oversight by Congress. Instead, Congress saw §507(a)(8)(A)(i) as serving a different function from that of setting periods in which the IRS could assess and collect taxes. That function was to *define* which taxes are dischargeable and which are not, not to set a time period for the *collection* of a tax.

Congress also explicitly dealt with tolling periods in the Bankruptcy Code at §108. This section, which is entitled "Extension of time" and which is applicable throughout the Code (§103(a)), provides for the tolling of statutes of limitation and the like when bankruptcy intervenes. As to claims pending *against* a debtor, §108(c)(2) provides, for example, that a statute of limitation that would expire under "applicable nonbankruptcy law" during the pendency of a bankruptcy case is extended and expires 30 days after termination or expiration of the automatic bankruptcy stay

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[2] IRC §6331(k)(1) and (2), enacted as part of the IRS Restructuring and Reform Act of 1998, codified prior IRS practice of suspending collection activity when an offer in compromise was filed in good faith.

arising under §362(a).[3]

Additionally, Code §108(c)(1) explicitly extends limitation periods by the amount of time "applicable non-bankruptcy law" itself suspends the running of a statute of limitation on account of a bankruptcy proceeding. This provision is tailor-made to fit with provisions of the IRC concerning the time for collecting taxes, and indeed the legislative history explicitly so states. The particular sections of the Internal Revenue Code involved are §6502 and 6503. Section 6502(a)(1) allows the IRS ten years (not three) in which to collect a tax once assessed. Section 6503 then sets forth nine paragraphs describing circumstances that further enlarge the ten-year collection period. Among these are subparagraphs (b) and (h):

> (b) The period of limitations on collection after assessment prescribed in section 6502 shall be suspended for the period the assets of the taxpayer are in the control or custody of the

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[3] Expiration and termination of the automatic bankruptcy stay is governed by §362(c) and (d) of the Code. The stay expires under §362(c)(2) upon the earliest of the closing of the case, dismissal of the case or the granting of a discharge. Additionally, while a case is pending, §362(d) allows a party in interest to request that the stay be terminated.

Of course, if the stay expires because a discharge has been granted, the creditor's claims against the debtor may have been discharged (see Code §524(a)) and extension of the statute of limitation would become moot. However, for a nondischargeable claim, such as a debt incurred through fraud (Code §523(a)(2)), the tolling provisions of Code §108(c) would enlarge the non-bankruptcy statute of limitation period in which suit could be brought.

> court in any proceeding before any court of the United States or any State or of the District of Columbia, and for 6 months thereafter.
>
> and
>
> (h) The running of the period of limitations provided in section 6501 or 6502 on the making of assessments or collection shall, in a case under title 11 of the United States Code, be suspended for the period during which the Secretary is prohibited by reason of such case from making the assessment or from collecting and—
>
> (1) for assessment, 60 days thereafter, and
>
> (2) for collection, 6 months thereafter.

Bankruptcy Code §108(c)(1) and IRC §§6502 and 6503(b) and (h) dovetail to enlarge the ten-year collection period (and the three-year assessment period under IRS §6501) by the ". . . period during which the Secretary is. . . prohibited by reason of [the debtor's bankruptcy] case from making the assessment or from collecting . . ."

This is precisely the result intended by Congress:

> In the case of Federal tax liabilities, the Internal Revenue Code suspends the statute of limitations on a tax liability of a taxpayer from running while his assets are in the control or custody of a court and for 6 months thereafter. . . . The amendment applies this rule in a title 11 proceeding. Accordingly, the statute of

> limitations on collection of a *nondischargeable* Federal tax liability of a debtor will resume running after 6 months following the end of the period during which the debtor's assets are in the control or the custody of the bankruptcy court. This rule will provide the Internal Revenue Service with adequate time to collect *nondischargeable* taxes following the end of the title 11 proceedings. (emphasis added)
>
> S.Rep. No. 989, 95th Cong., 2nd Sess. 30-31 (1978), U.S. Code Cong. & Admin. News 1978, pp. 5787, 5816, 5817.

The reference in the Senate Report quoted above to "nondischargeable" taxes is telling. It demonstrates that Congress designed these tolling provisions to allow the IRS additional time to collect nondischargeable taxes when the taxpayer's bankruptcy proceedings intervene. They do not, however, define which taxes are dischargeable in the first place. Congress has properly left the task of defining which taxes are dischargeable to the Bankruptcy Code, and the three-year aging rule originally enacted in 1966 and now found at Code §507(a)(8)(A)(i) is part of the definition. It belies the assertion made by many courts, including the bankruptcy court below, that "It is clear that Congress intended the IRS to be granted three years to collect taxes. . . ." App. to Pet. for Cert. 21a.

IV. THE ASSUMPTIONS THAT UNDERLIE THE HOLDINGS OF THE COURTS THAT ADHERE TO THE MAJORITY VIEW ARE FAULTY.

Despite the statutory structure portrayed above — and the legislative history that supports it — the majority of courts

that have considered the issue have engrafted a tolling or extension period onto the three-year period set out at Code §507(a)(8)(A)(i). These courts have done so using several assumptions and premises, none of which hold up upon closer examination.

A. The IRS is not barred by the automatic bankruptcy stay from collecting money from debtors who are in reorganization cases.

The first of these faulty assumptions is that the IRS is completely barred by the automatic stay from collecting any money from a debtor during his earlier bankruptcy proceeding. For example, the court of appeals in *Richards v. United States (In re Richards)*, 994 F.2d 763 (10th Cir. 1993) asserts that the government was prevented from collecting taxes because of the automatic stay in Mr. Richard's first chapter 13 proceeding. *Richards*, at 765. Likewise, in *In re Taylor*, 81 F.3d 20 (3rd Cir. 1996), the court asserted that the IRS was "completely barred from collecting. . ." taxes during the Taylors' earlier chapter 13 proceeding, *Id.* at 23. Similarly, the court in *Waugh v. IRS (In re Waugh)*, 109 F.3d 489 (8th Cir. 1997), *cert. denied*, 522 U.S. 823 (1997), asserted at page 494, that ". . . in Waugh's case, the automatic stay prevented the IRS from collecting Waugh's 1987 taxes from July 1, 1988 until February 6, 1991." Finally, in *Brickley v. United States (In re Brickley)*, 70 B.R. 113 (9th Cir. B.A.P. 1986) the court stated at page 115, "The Debtor's argument that the IRS failed to collect its taxes within the three-year period of non-dischargeability ignores the fact that their property was unreachable during most of that time."

The assumption that the IRS can collect nothing from a debtor during the debtor's earlier bankruptcy proceeding is

incorrect. In almost every case, the prior proceeding is a reorganization under chapter 13 or chapter 11 of the Bankruptcy Code. In contrast to an individual's chapter 7 proceedings,[4] reorganization cases can last years.

Yet during these years, the IRS is, or should be, collecting taxes from the debtor notwithstanding the fact that the automatic stay remains in force. In chapter 13, a debtor is required to file a plan. Code §1321. The plan must provide for "full payment, in deferred cash payments, of priority claims under section 507," including, of course, priority tax claims. Code §1322(a)(2). The plan must be filed within 15 days of the filing of the chapter 13 petition, unless this deadline is extended by the court. Bankruptcy Rule 3015(b). The debtor is required to commence making payments as proposed in his plan within 30 days after the plan is filed, §1326(a)(1), and the chapter 13 trustee is required to make distributions to creditors once the plan is confirmed. Code §1326(a)(2).

Similarly, a debtor in a chapter 11 proceeding has the exclusive right to file a plan for the first 120 days after an

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[4] An individual chapter 7 case can in theory last as little as 81 days from the filing of the chapter 7 petition — which establishes the automatic stay under Code §362(a) — to granting of the debtor's discharge, which dissolves the stay, Code §362(c)(2)(C). Bankruptcy Rule 2003(a) requires that a meeting of creditors be held twenty to forty days after the petition is filed, and Bankruptcy Rule 4004(a) and (c) requires the court to grant a discharge after sixty days has elapsed from the first date set for the meting of creditors. The government implied in its brief in the court of appeals below that the short period that the automatic stay remains in effect in a chapter 7 case is not a significant hindrance to its collection efforts. Brief for the Appellee, at 11 and 14-15.

order for relief is entered. Code §1121(b). A hearing is held on confirmation of the plan, Code §1128(a), and the plan is thereupon confirmed if it meets the requirements of Code §1129. Income tax claims as defined in §507(a)(8) must be paid in full, with interest, in deferred cash payments made over a period not exceeding six years from the date of assessment of the tax. §1129(a)(9)(C). Under Code §1141(d)(2), the chapter 11 discharge does not discharge an individual debtor from debts excepted from discharge under Code §523, which of course includes recently-incurred income tax liabilities.

These provisions, then, require debtors in reorganization proceedings to file and confirm plans that pay their priority tax obligations in full within a maximum of five (chapter 13) or six years (chapter 11). Against this background, the claims of the IRS for court intervention because of the bar of the automatic stay fall flat. The *Brickley* case provides a good illustration of this.

In *Brickley*, the debtors filed their chapter 13 petition in November 1981. The court's opinion does not state whether the debtors' plan was confirmed, but it does say that the Brickleys ". . . were unable to make all the payments required under their Chapter 13 plan." *Id.* at 114. Because of this, the debtors filed a motion to terminate their chapter 13 on August 9, 1984, about two years and nine months after the filing of their chapter 13 petition. They then filed a chapter 7 petition on October 3, 1984, and subsequently received a chapter 7 discharge. They argued that their 1979 and 1980 income tax obligations were discharged in the chapter 7 proceeding.

The court's opinion in *Brickley* does not state whether the debtors' chapter 13 plan was confirmed. If it was, it

presumably provided for the payment in full of the debtors' 1979 and 1980 income tax obligations to the IRS in accordance with §1322(a)(2) of the Bankruptcy Code. If the debtors' plan had not provided for payment in full of the tax obligations, the IRS could have objected to confirmation. Assuming the plan did provide for full payment, the IRS should not have been allowed to complain about being prohibited from collecting taxes from the bankruptcy debtors, since the IRS was, under the debtors' plan, collecting taxes from the bankruptcy debtors.

If, on the other hand, the IRS was not collecting taxes from the Brickleys because the plan for some reason had not been confirmed during the two years and nine months they were in chapter 13, or because the Brickleys were not making payments under a confirmed plan, the IRS could have moved to dismiss or convert the case under §1307(c) of the Bankruptcy Code for any of the numerous reasons set forth there, including unreasonable delay by the debtor that is prejudicial to creditors (§1307(c)(1)), failure to commence making timely plan payments (§1307(c)(4)), or material default by the debtor with respect to a confirmed plan (§1307(c)(6)). In sum, the IRS should not be allowed to collect tax payments from chapter 13 debtors and then argue that they did not have a fair opportunity to collect taxes from them. Nor should the courts enact a tolling period where none exists simply to bail out the IRS for sitting on its hands and doing nothing while a chapter 13 case is pending.

The vacuity of the IRS' argument for automatic tolling of the three-year period of §507(a)(8)(A)(i) for the duration of the debtor's prior bankruptcy is illustrated in *In re Gore,* 182 B.R. 293 (Bankr. N.D. Ala. 1995). In that case, the debtors filed a chapter 13 proceeding without listing the IRS as a creditor, even though they owed taxes to the IRS. The

debtors' plan made no provision for paying the IRS, and because of its lack of notice of the proceeding, the Service would not have willfully violated the automatic stay had it attempted to collect the debtors' tax obligation during the chapter 13 proceeding. The IRS, however, did not.

The chapter 13 proceeding was dismissed 169 days after it began. The debtors subsequently filed a chapter 7 case more than 3 years after the due date of their tax return and claimed, as a result, that their tax obligation had been discharged. The IRS claimed otherwise, arguing that the prior chapter 13 proceeding had tolled or extended the three-year period by the 169-day duration of the chapter 13 proceeding. The court, noting that the IRS had not even assessed, much less attempted to collect, the taxes at issue until after the chapter 13 proceeding had been dismissed, held that the taxes were discharged.

B. The three-year period in Bankruptcy Code §507(a)(8)(A)(i) is not a collection period, but defines which taxes are dischargeable.

Other excuses given by courts as reason to adhere to the majority view are that the IRS is entitled to a full three years to collect priority taxes unencumbered by the automatic stay, and that adding a tolling provision to the three-year period in §507(a)(8)(A)(i) prevents potential taxpayer abuse and tax evasion.

As we have argued earlier at §§ II B. and III of this brief, the three-year period was never intended to set out a period for collecting taxes. Instead Congress intended it to be a part of the definition of which tax obligations are so stale that they should be discharged, and which are not. The only

true tax collection period in the Bankruptcy Code is the 240-day period from assessment set forth at 507(a)(8)(A)(ii). *United States v. Aberl (In re Aberl)*, 78 F.3d 241 (6th Cir. 1996); *Gore v. United States* at 310.

C. The Bankruptcy Code already contains ample restraints on taxpayer manipulation and abuse.

Finally, courts adhering to the majority view point to the potential for abuse and tax evasion by debtor-taxpayers. These claims are exaggerated. A debtor entering into a reorganization proceeding must, as we have seen, submit and confirm a plan that pays his nondischargeable taxes in full. The maximum period for completing payments is five years in chapter 13, and six years from the date of assessment in chapter 11. These are shorter than the ten-year period of IRC §6502 that the IRS has to collect taxes, and nothing guarantees the IRS will collect all it is owed during the ten years. For example, some delinquent taxpayers enter into installment agreements to pay overdue taxes. Such agreements are authorized by IRC §6159. Under this procedure, the taxpayer fills out a collection information statement, form 433-A (or possibly the shorter version, form 433-F). On this form, the taxpayer sets forth his assets and the encumbrances thereon, and, importantly, his monthly income and necessary living expenses. Allowance of important categories of expense, such as housing and transportation, may be limited by the IRS' so-called National Standards and Local Standards. These the IRS has compiled from census and other data to determine reasonable cost of living amounts for the geographical area in which the taxpayer resides. Payments on credit card balances and personal loans are not considered reasonable if allowing payment of them would prevent the taxpayer from paying his tax liability in full

in three years. Internal Revenue Manual 5323.434.

Once a taxpayer has completed the 433-A (or 433-F) form, and downward adjustments are made for non-allowable expenses, there should be left a surplus of income over expenses of, say, $200 per month. This amount then becomes the amount of the monthly installment payment which is entered onto the installment agreement, form 433-D, and then signed. The taxpayer may also be required to sign an agreement extending the 10-year collection period under IRC §6502. The taxpayer then begins making payments to the IRS.[5]

Notably, the amount of the taxpayer's monthly installment was determined by his current income and reasonable living expenses, and not by the size of his unpaid tax obligation. Two hundred dollars a month may pay his obligation in full in three years, or it may not. If the obligation is large, $200 per month may barely keep pace with interest and penalties that continue to accrue. The payments may or may not amortize the full obligation over the 10-year collection period of IRS §6502, or even during a longer period enlarged by an agreed-upon extension of the 10-year period. The point, of course, is that even a fully-implemented installment agreement does not guarantee that past-due taxes will be paid in full before the 10-year collection period expires, whereas a successfully-completed bankruptcy plan does in five or six years.

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[5] Our hypothetical describes in simplified terms the process of entering into an installment agreement with the IRS. For a more thorough description, see R. Schriebman, *IRS Tax Collection Procedures*, chapter 4 (2001).

Also, contrary to the fears expressed in the majority holdings, debtors find it difficult to dive into bankruptcy court and tread water there for three years without filing and confirming a plan of reorganization that provides for payment in full of the debtor's nondischargeable tax obligation. In addition to the weapons of Code §§1112(b) and 1307(c), the IRS can object to confirmation of a debtor's plan (Code §§1128(b) and 1324). The filing of a bankruptcy petition must be in good faith. *Carolin Corp. v. Miller*, 886 F.2d 693 (4th Cir. 1989); *In re Love*, 957 F.2d 1350 (7th Cir. 1992). To be confirmed, plans must be proposed in good faith. Code §§1129(a)(3) and 1325(a)(3). Failure to confirm is grounds for dismissal. Dismissal dissolves the automatic stay, permitting collection once again by the IRS. Collection can include the filing of notices of tax liens on all of the debtor's real and personal property. The bankruptcy court can also, on dismissal, bar the discharge of a debt in a subsequent filing "for cause" under Code §349(a). Finally, §105(a) explicitly authorizes a bankruptcy court enter appropriate orders to prevent an "abuse of process."

V. BANKRUPTCY CODE §105(a) DOES NOT PERMIT THE BANKRUPTCY COURT TO CONTRADICT EXPLICIT PROVISIONS OF THE BANKRUPTCY CODE.

None of the courts below, whether the bankruptcy court, district court or court of appeals, rested its holding upon Bankruptcy Code §105(a), so this not before this Court in this case. Furthermore, the bankruptcy court below explicitly found that ". . . the Court imputes no bad faith on the Plaintiffs. . . ." However, as some courts of the majority persuasion have rested their holdings at least in part on the provisions of §105(a), some discussion of the scope of this section is in order. Section 105(a) provides that:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

This Court has not become deeply involved with the application of §105(a) in recent years. Even where §105(a) played a prominent role in a case before the Court, *Celotex Corp. v. Edwards*, 514 U.S. 300 (1995), this Court found that it did not have to review the propriety of the bankruptcy court's broad injunction issued under §105(a): ". . . we need not, and do not, address whether the Bankruptcy Court acted properly in issuing the Section 105 Injunction." *Id.* 312.

In *Johnson v. Home State Bank*, 501 U.S. 78 (1991), the Court's opinion noted that ". . . the bankruptcy court retains its broad equitable power to 'issue any order, process or judgment that is necessary or appropriate to carry out provisions of [the Code]' §105(a)," *id.* 89, but the holding in *Johnson* does not rest on this section. In *United States v. Energy Resources Co.*, 495 U.S. 545 (1990), this Court pointed out that bankruptcy courts are indeed courts of equity, *id.* 549, but upheld the order of the bankruptcy court below primarily on the basis of §1123(b)(6), which specifically allows reorganization plans to "include any other appropriate provision not inconsistent with the applicable provisions of this title." Section 105(a) is mentioned simply as an additional basis for affirming the holdings below.

The most significant recent decision of this Court that deals with equity powers granted to bankruptcy courts under the Bankruptcy Code is *United States v. Noland*, 517 U.S. 535 (1996). Here, this Court dealt with the doctrine of equitable subordination under §510(c) of the Code. The bankruptcy court below had subordinated certain IRS tax penalties to classes of claims having a lower priority of distribution under §507. This Court held that even the flexible doctrine of equitable subordination under §510(c) did not permit the bankruptcy court to reorder the priorities mandated by Congress under §507 in a categorical fashion: "The equity chancellor never did, and does not now, exercise unrestricted power to contradict statutory or common law when he feels a fairer result may be obtained by application of a different rule." *Id.* 542, quoting from *In re Ahlswede*, 516 F.2d 784 (9th Cir.).

Although this Court has not recently had reason to consider §105(a) in depth (the *Noland* opinion does not mention §105(a)), the holding in *Noland* is consistent with the views of a number of courts of appeals which have dealt explicitly with §105. They have repeatedly held that although §105(a) confers broad equitable powers on bankruptcy courts, such powers must be used only to "carry out" the provisions of the Code without fashioning or altering substantive rights of debtors or creditors.

> Section 105(a) empowers the bankruptcy court to exercise its equitable powers — where "necessary" or "appropriate" — to facilitate the implementation of other Bankruptcy Code provisions...Although expansively phrased, Section 105 (a) affords bankruptcy courts considerably less discretion than first meets the eye, and in no sense constitutes "'a roving

commission to do equity.'" *Chiasson v. J. Louis Matherne & Associates (In re Oxford Management, Inc.)*, 4 F.3d 1329, 1334 (5th Cir. 1993) (citation omitted). See *In re Lapiania*, 909 F.2d 221, 224 (7th Cir. 1990); *Donovan v. Bundy (In re Donovan)*, 183 B.R. 700, 702 (Bankr. W.D. Pa. 1995) (same). Instead, the equitable discretion conferred upon the bankruptcy court §105(a) "is limited and cannot be used in a manner inconsistent with the commands of the Bankruptcy Code." *In re Plaza de Diego Shopping Center, Inc.*, 911 F.2d 820, 824 (1st Cir. 1990). These limitations have been variously described.

First, Bankruptcy Code §105(a) may not be invoked to alter substantive debtor rights defined under the applicable nonbankruptcy law. See, e.g., *Bird v. Carl's Grocery Company (In re NWFX, Inc.)*, 864 F.2d 593, 596 (8th Cir. 1988) ("An 'equitable setoff' such as that fashioned by the bankruptcy court in the present case is not a proper use of the bankruptcy court's equitable powers because it creates new substantive rights for the parties. . . ."); see also *In re Continental Airlines Corp.*, 907 F.2d 1500, 1509 (5th Cir. 1990) (holding that §105(a) does not permit substantive modifications of labor agreement).

Noonan v. Secretary of Health & Human Services (In re Ludlow Hospital Society., Inc.), 124 F.3d 22, 27 (1st Cir. 1997)

Similarly, the court in *In re Barberi*, 199 F.3d 616 (2nd Cir. 1999) stated: "In addition, the District Court's reliance on 11 U.S.C. §105(a) is misplaced. The equitable powers emanating from §105(a) . . . are not a license for a court to disregard the clear language and meaning of the bankruptcy statutes and rules." *Id.* 620-21 (internal quotes and citations omitted). Likewise, the court in *Kestell v. Kestell*, 99 F.3d 146 (4th Cir. 1996), while holding that §105 is the "basis for a broad exercise of power in the administration of a bankruptcy case," *id.* 148, went on to add that "Section 105 is not, or course, unlimited. It cannot be invoked, for example, to achieve ends contrary to other specific Code provisions." *Id.*

Since Congress has set forth detailed provisions in the Bankruptcy Code to determine which taxes are dischargeable and which are not, bankruptcy courts have no power under §105(a) to hold that a tax dischargeable under a clear provision of the Bankruptcy Code is nevertheless not discharged.

CONCLUSION

For the reasons set forth above, this Court should reverse the holding of the United States Court of Appeals for the First Circuit and hold that the Youngs' 1992 income tax obligation was discharged by their chapter 7 bankruptcy.

Respectfully submitted,

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